

# FISCAL NOTE

**Bill #:** HB0721

**Title:** Revise water's edge election for corporate taxation

**Primary Sponsor:** Erickson, R

**Status:** 2<sup>nd</sup> Reading, As Amended

Sponsor signature	Date	Chuck Swysgood, Budget Director	Date
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## Fiscal Summary

	<b>FY 2004 Difference</b>	<b>FY 2005 Difference</b>
<b>Revenue:</b>		
State Special Revenue	\$0	\$375,000
<b>Net Impact on General Fund Balance:</b>	\$0	\$0

- |   |   |
|---|---|
| <input type="checkbox"/> Significant Local Gov. Impact<br><input type="checkbox"/> Included in the Executive Budget<br><input type="checkbox"/> Dedicated Revenue Form Attached | <input type="checkbox"/> Technical Concerns<br><input checked="" type="checkbox"/> Significant Long-Term Impacts<br><input type="checkbox"/> Needs to be included in HB 2 |
|---|---|

## Fiscal Analysis

### ASSUMPTIONS:

1. This bill, which applies to tax periods beginning after December 31, 2003 (CY2004), changes the manner in which the state taxes corporations electing to file under the "water's edge" method of income apportionment by requiring that the corporation's return must include the income and apportionment factors for any corporation that is in a unitary relationship with the filing corporation and that also is incorporated in a "tax haven".
2. The bill specifically provides that any income shifted to a tax haven, to the extent that it is otherwise taxable, must be considered income subject to apportionment for state tax purposes.
3. An accurate estimate of the fiscal impact of this proposal would require knowing the amount of income currently being sheltered in tax havens by corporations electing to take the water's edge filing approach in Montana. The Department of Revenue does not have this information; hence, no precise estimate of the fiscal impact of this proposal can be done at this time. Certain information can be used, however, to provide for a "reasonableness" test of the impact of this bill. The following table shows the number of corporations that have elected to use the water's edge approach to corporate income tax filing in Montana, and the total tax liability reported by these companies over the period fiscal 1992 to 2000. It is assumed that this bill could potentially increase revenue from corporations filing a water's edge election by as much as 10%. Over the above period, this would represent an average increase of about \$295,000 a year. However, it is apparent that over the above time period the trend has been increasing as a larger number of corporations have filed using the water's edge approach. For the purposes of this fiscal note, and based on the last six years of information available, it is assumed that the annualized impact from this proposal would be to increase revenues to the general fund by \$375,000 a year. (Average total tax liability over the 1995-2000 period of \$3,742,500 times 10% equals about \$375,000 each year.)

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Number of Corporations Filing Water's Edge and Total Tax Liability; Fiscal Years 1992 - 2000		
Fiscal Year	Number of Corporations	Total Tax Liability
1992	22	\$1,228,000
1993	24	\$1,337,000
1994	27	\$1,567,000
1995	37	\$3,034,000
1996	45	\$5,567,000
1997	47	\$2,808,000
1998	57	\$1,941,000
1999	72	\$3,988,000
2000	66	\$5,117,000

4. This bill applies to tax periods beginning after December 31, 2003. Most corporations, but not all, file returns based on a calendar year tax period, and all of these take the automatic 6-month extension of time to file their returns. These are the earliest returns that would be impacted by this bill, and would not be filed until November 2005 (fiscal year 2006). However, it is assumed that at least some of the corporations impacted by this bill will increase their quarterly estimated tax payments to take this bill into account. While it is theoretically possible that this could happen as early as fiscal 2004, it is assumed that this bill has no impact in that fiscal year. Adjustments to quarterly estimated tax payments will provide for an increase in fiscal year 2005 of the total annualized amount of \$375,000; and total tax revenues will increase in each fiscal year thereafter by a similar amount.
5. The bill, as amended, provides that for fiscal year 2005 the tax from water's edge corporations must be deposited \$375,000 in the state special revenue fund to the credit of the Department of Public Health and Human Services for state matching funds for medicaid health services, and the balance to the state general fund. This will result in the entire increase in revenue from this bill of \$375,000 being deposited in the state special revenue fund in fiscal 2005.
6. There are no administrative expense impacts on the Department of Revenue from this proposal.

**FISCAL IMPACT:**

	FY 2004 <u>Difference</u>	FY 2005 <u>Difference</u>
<u>Revenues:</u>		
State Special Revenue (02)	\$0	\$375,000
<u>Net Impact to Fund Balance (Revenue minus Funding of Expenditures):</u>		
State Special Revenue (02)	\$0	\$375,000

**EFFECT ON COUNTY OR OTHER LOCAL REVENUES OR EXPENDITURES:**

No impact.

**LONG-RANGE IMPACTS:**

Revenue to the state general fund is anticipated to increase annually by about \$375,000 beginning in fiscal year 2006.